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C O N F I D E N T I A L SECTION 01 OF 04 BAKU 001042

SIPDIS

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FOR EUR/CARC

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TAGS: [PREL](#) [PGOV](#) [ECON](#) [AJ](#) [CH](#) [GG](#) [TU](#)

SUBJECT: AZERBAIJAN'S RELATIONS WITH CHINA

Classified By: DCM Donald Lu for reasons 1.4 (b, d).

¶1. (C) SUMMARY: Relations between Azerbaijan and China are warm, with the potential for increased economic cooperation in select spheres, particularly Chinese exports of consumer goods and investment in manufacturing projects such as the Ganja automobile assembly plant. China's involvement in Azerbaijan's oil and gas projects is limited to the on-shore Kursengi-Garabaghli field; China also appears interested in the sale of oil extraction equipment. Mutual support for each other's separatist problems -- Nagorno-Karabakh and Taiwan -- is a key pillar of the bilateral relationship. END SUMMARY.

#### SHARED SEPARATIST PROBLEMS

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¶2. (C) Baku and Beijing's support for each other's positions on Nagorno-Karabakh and Taiwan is the political bedrock of the relationship. A constant theme during Azerbaijani-Chinese visits is mutual support for each other's respective territorial-separatist problems. Public statements during official visits typically reference Baku's position that there is "only one China," while Beijing's statements back Azerbaijan's "sovereignty and territorial integrity." In our meetings with Azerbaijani and Chinese diplomats, both sides affirmed that support for the other's separatist problem was a pillar of the bilateral relationship.

#### LIMITED ENERGY CONTRACTS

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¶3. (C) Despite Beijing's growing interest in acquiring new sources of energy, it is a limited player in Azerbaijan's oil and gas projects. Local contacts report that China's role in Azerbaijan's energy projects is confined to smaller onshore projects. Ilham Shabanov, an energy expert at Turan News Agency, told us that Beijing did not seek to be a central participant in any of Azerbaijan's large-scale energy contracts during the latter 1990s. Shabanov suggested China began to take a more active interest in Azerbaijan in approximately 2000. China sought to gain a share in several smaller, onshore energy contracts that were less-publicized. Shabanov highlighted the Chinese National Petroleum Corporation (CNPC) and the Shengli Oil company as examples of companies that pursued low-profile, onshore projects that other companies have passed over. (NOTE: CNPC has a 62 percent share in the onshore Southwest Gobustan gas and oil exploration project, according to the Department of Energy's

Energy Information Administration. Shengli Oil company has concluded several oil exploration agreements in Azerbaijan. END NOTE.)

14. (C) According to BP employee Seymour Khalilov, the key onshore fields where China is involved in extraction are located at Garachukhur, Southwest Gobustan, Pirsaat, and Kursengi-Garabaghli. The Chinese National Petroleum Company (CNPC) -- either directly or indirectly through subsidiary companies such as Fal China -- plays a lead role in these projects, according to Khalilov.

15. (C) Khalilov said that China's participation in Salyon Oil's exploration of the Kursengi-Garabaghli field is Beijing's top investment in Azerbaijan's energy sector. Two CNPC subsidiary companies, Fal China and the China National Oil and Gas Exploration and Development Corporation, each have a 25 percent share in the project. (NOTE: According to a contractual study on Azerbaijan's oil production by Shabanov, the Kursengi-Garabaghli field is not a major oil field relative to the more important offshore sites such as Azeri-Chirag-Gunashli, although it is one of the larger onshore fields. According to this same study, there was a 7.6 percent drop in production at the Kursengi-Garabaghli field during the 2006 and first quarter of 2007 timeframe.) AmCham Board Member (and former US Ambassador) Stanley Escudero said that China's role in the Kursengi-Garabaghli field was primarily driven by a desire to sell energy extraction equipment in Azerbaijan. More broadly, Escudero argued that China's top interests in Azerbaijan's energy sector are to gain a market share in oil and gas extraction equipment and petro-chemical plants.

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#### BACKGROUND ON ECONOMIC COOPERATION

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16. (C) Ministry of Foreign Affairs Eastern Asian Division Director Elchin Seyidov told us the bilateral relationship is on a solid footing and has been gradually expanding. Remarking on the overall relationship, Seyidov commented that "China has established itself as a solid partner to Azerbaijan." Seyidov highlighted several important dates in the relationship: diplomatic relations were established in 1992, Azerbaijan opened an embassy in Beijing in 1993, former President Heydar Aliyev visited China in March 1994, and President Ilham Aliyev visited in March 2005. Seyidov said over 35 bilateral agreements have been signed, covering a broad range of issues from transportation to economic cooperation to cultural exchanges.

17. (C) Shabanov told us that corrupt business deals were a key feature of bilateral relations in Azerbaijan's initial post-independence period. In particular, there were several suspect agreements between Chinese construction companies and the State Oil Company of Azerbaijan (SOCAR). Shabanov claimed that Rasul Guliyev, who served as the Vice President of SOCAR in the early 1990s and is now an oppositionist in-exile, was heavily involved in these dealings.

#### SELECTIVE ECONOMIC GROWTH

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18. (C) Local contacts report that China has modest economic interests in Azerbaijan, particularly as an export market. Seyidov and Wiedong told us the trade volume between Azerbaijan and China for 2006 was approximately USD 300 million. According to the Economist Intelligence Unit (EIU), China is the fifth largest source of imports (5.3 percent) for Azerbaijan, trailing Russia (17.1 percent), Germany (9.1 percent), UK (7.4 percent), and Turkey (6.1 percent). While the Chinese share of Azerbaijan's imports remains modest, the EIU observes that China's importance as a supplier of consumer goods to Azerbaijan is growing. Seyidov told us that China's primary exports to Azerbaijan are home

appliances, metallic equipment, spare automobile parts, cars, clothes, and shoes. China seeks to increase exports in the following categories: textiles, industrial goods, road construction services, and other construction-related equipment. Elshan Mammadzadeh, Head of the International Economic Cooperation Department at the Ministry of Economic Development, also highlighted that the key areas of growth for Chinese imports in 2006 were soaps, cleaners, plastic goods, mechanical and electrical appliances, and associated spare parts.

¶9. (C) According to Mammadzadeh, there was a 30 percent growth in imports from China, comparing the first three quarters of 2005 and 2006. Despite this increase, there was a net decline in the total trade turnover between Azerbaijan and China. (NOTE: According to these figures, there was a 30 percent rise in imports from China and a 87 percent decrease in Azerbaijani exports to China. While we cannot verify these numbers -- given the black box of official GOAJ statistics -- the reported increase in China imports tracks with our anecdotal observations at local stores and bazaars that China sees Azerbaijan as an export market.

¶10. (C) The GOAJ statistics however, report a decline in toys and sporting goods from China, even though local stores and markets are awash with these items. The two most likely explanations for this seeming aberration on toys and sporting goods are a member of the elite has a share of this trade or the trade is being pushed into the black market, where the GOAJ cannot track the volume of trade.

¶11. (C) During a meeting with pol/econ chief, Chinese Embassy Counselor Sun Wiedong downplayed the level of China's economic interests in Azerbaijan. Wiedong maintained that China's interest in Azerbaijan's energy sector is minimal. According to Wiedong, China annually purchases approximately 20 million tons of oil from Azerbaijan and this is only a minor amount based on China's total oil consumption. Wiedong also said Beijing has seen little benefit from its investments in Azerbaijani on-shore oil projects.

¶12. (C) The majority of average Azerbaijanis have a negative  
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view of China's influence in Azerbaijan. Most see China as an exporter of cheap consumer goods to Azerbaijan. Azerbaijanis are naturally suspicious of China's geopolitical intentions in Eurasia and are quick to criticize the quality of Chinese products. Many stores in Baku carry a variety of cheap Chinese plastics, clothing, or household goods. For example, Shabanov estimated that 80 percent of the goods sold at Baku's Airport Bazaar -- the largest market in Azerbaijan -- are from China. Shabanov also claimed that China earns more money from the sale of consumer and textile goods than from its oil contracts.

#### OTHER ECONOMIC VENTURES -----

¶13. (C) Local contacts point to Chinese investment in a Ganja automobile manufacturing plant as a key benchmark to gauge the state of Azerbaijani-Chinese economic cooperation. According to local press, Chinese corporations Li Fan and Chan Gan agreed with the Ganja automobile assembly plant in July 2006 to produce Chinese autos. In the same month, the plant announced that it would cease producing Russian UAZ automobiles, citing the poor quality of the cars' parts.

¶14. (C) It remains unclear whether this new venture will be profitable. In one early indication of success, local press reported that the factory opened an office in the Azerbaijani exclave of Naxchivan in September 2006 to sell the Chinese cars. In April, during a trip to Ganja, we repeatedly attempted to arrange a visit to the factory through a local executive authority (ExComm) representative. The official was evasive with our request. When we asked local Ganja

residents about the factory, they played down the importance of Chinese cars, observing that the factory was not very active and also produced other foreign vehicles, including Belarussian tractors.

#### SUPPORT FOR THE RAILROAD UNDER QUESTION

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¶15. (C) The GOAJ likes to point to the Kars-Akhalkalaki-Tbilisi-Baku railway project as a exemplary project showcasing Azerbaijan's regional leadership. Local interlocutors and press occasionally highlight China's interest in participating in this grand project, by linking up with the Kazakhstani railroad system. Proponents of the railroad argue that the new transit route would broaden China's access to European and other regional markets. Chinese Counselor Wiedong privately was less enthusiastic about Beijing's interest in this project. He told pol/econ chief that the media rhetoric about the project does not yet match reality. Wiedong did note, however, that China would like to take part in the project if it was capable of advancing Beijing's interest in increased market access to Europe and Eurasia.

#### EVERY RELATIONSHIP HAS ITS WRINKLES

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¶16. (C) There are episodic incidents that introduce tensions in the relationship. Seyidov mentioned that in 1998-1999, the GOAJ was displeased with reports that China sold missiles to Armenia. Local press from September 2006 reported the GOAJ was investigating reports that Beijing sold missiles to Yerevan. While Post cannot confirm the veracity of these reports, the public nature of the two episodes suggests there are periodic wrinkle in the relationship. Seyidov also noted a problematic agreement between Chinese Oilfield Services and the Iranian North Drilling company for the repair and upkeep of a floating platform that could be used at the Alov oilfield. (NOTE: The Alov oilfield is located in a section of the Caspian Sea that is disputed between Azerbaijan and Iran.) Finally, Seyidov raised a 2005 incident in which a Chinese chess player sought to attend an chess match in Khanakendi/Stepanakert without permission from the GOAJ. After the GOAJ criticized the illegal nature of the competition, the Chinese citizen did not attend the match.

#### GOAJ INFIGHTING MAY RESTRAIN TIES TO BEIJING

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¶17. (C) Inter-elite squabbles within the GOAJ may limit bilateral economic cooperation. Shabanov told us some elites

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favor closer ties with South Korea, rather than China. Specifically, Shabanov claimed Deputy Prime Minister Yagub Eyyubov backed close ties with China, while Minister of Emergency Management Kamaladdin Heydarov favored links to South Korea, because Heydarov has a financial cut on the import or sale of South Korean Hyundais in Azerbaijan. (A South Korean company recently was awarded a large contract to develop new commercial port facilities in Baku.)

#### COMMENT

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¶18. (C) Support for their separatist conflicts and China's interest in Azerbaijan as an export market appear to be the "glue" binding this bilateral relationship. Azerbaijan, which aspires to a regional leadership role and is increasingly confident in its foreign policy approach, probably sees ties with China as an opportunity to showcase its multi-vector foreign policy and win more international support for its position on the Nagorno-Karabakh conflict. Geographical distance, Azerbaijanis' general dislike for Chinese products, and Baku's preference for a western-oriented foreign policy will, however, constrain the

overall development of this relationship.  
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